House Bill 375 and the other severance tax proposals

Review and recommendations

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House Bill 375 proposes the lowest rates and most generous provisions for the oil and gas industry of three severance tax proposals considered in Ohio during the past year. This analysis compares current Ohio law with HB 375, introduced on Dec. 4, 2013 and sponsored by Matt Huffman, R-Lima, and two others: the Kasich administration proposal included in (and removed from) HB 59, the budget bill for fiscal years 2014-15; and HB 212, introduced by Rep. Bob Hagan, D-Youngstown.

HB 375 at a glance

- Ohio severance tax on oil and gas would remain among the lowest of producing states.
- Tax credits and carve-outs could cost $800 million over 10 years.
- Taxes and fees cut in half for conventional (vertical) oil and gas wells.
- Fracked (horizontal) wells excluded from state's Commercial Activity Tax.
- Revenues used to cut income taxes, wealthy get largest cuts.
- Public won't get fair return for use of valuable natural resource.

Our comparison reveals important differences:

- HB 212 proposes severance tax rates and uses of severance tax revenues similar to those of major producing states.
- The Kasich proposal included a rate similar to the region on oil and natural gas liquids, but lower than for dry gas. It proposed using most of the revenue for income-tax cuts, which would have benefited wealthy households more than middle- and lower-income households.[1]
- HB 375 proposes the lowest severance tax rates of the three proposals. The sponsor anticipates tax credits and carve-outs will cost $800 million over 10 years.[2] Most of the revenue will be used for income-tax cuts, benefitting the wealthiest Ohioans.

Ohio legislators are responsible for negotiating fair payment for the extraction of natural resources and using the proceeds to build lasting value for the people of the state. HB 375 would improve the severance tax on oil and gas in Ohio, but provisions of the bill need to be strengthened or changed. In its current form, it undersells a valuable resource. Recommendations to improve the bill include:

- **Raise the tax rates.** HB 375's severance tax rates are lower than most oil- and gas-producing states, particularly states with active drilling in shale. They need to be higher, in line with other fracking states.
- **Provide ODNR with funding necessary for mandated work.** HB 375 reduces the Department of Natural Resource's share of severance tax proceeds by reducing rates on some production and repealing the regulatory cost recovery assessment. The bill would reduce

[1] Policy Matters Ohio: "Ohio needs a strong income tax," at www.policymattersohio.org/strong-income-taxfeb2012.
[2] Gongwer Ohio, "Huffman pitches severance tax proposal: oil industry not united in support," Volume #82, Report #238--Tuesday, December 10, 2013 at http://bit.ly/1dKgFLy.

revenue supporting oversight, reclamation and mapping even as the industry expands rapidly. The eventual cost of oversight of a fracking boom may be higher than anticipated today.

- **Trim and target tax breaks.** HB 375 subsidizes the oil and gas industry through tax credits and exclusions, yet requires nothing in return. With its new severance tax, Illinois uses subsidy to benefit working families. Subsidies should seldom be given, but when they are, they should incentivize specific behavior, like hiring Ohio workers rather than out-of-state work crews.
- **Eliminate or narrow the cost recovery period.** Horizontal drilling and well stimulation are high-cost, high-yield techniques that are standard for extraction of shale resources. The tax code should evolve as technology does. Ohio does not need to adopt tax favors fought for by the oil and gas industry in other states and earlier decades.
- **Eliminate the exclusion from the CAT.** The exclusion from the state's Commercial Activity Tax for horizontal-well production that would be taxed under HB 375 is a special-interest carve-out. Carve-outs have been opposed by many stakeholders to prevent exclusions and breaks from eroding the CAT's efficiency and forcing rates to rise.
- **Eliminate or narrow the income tax credit.** This tax credit goes far beyond helping landowners with bad lease terms and could be very costly. Auditing could be difficult: ownership interests may be finely parsed, widely dispersed, with widespread assignment of tax benefit.
- **Base the severance tax on gross value instead of net proceeds.** The language in HB 375 that defines "net proceeds" as allowing the exclusion of "any" post-production costs invites excessive deductions in a way that "gross value" does not.
- **Use severance tax proceeds to meet the needs of Ohioans.** HB 375's proposed use of severance tax revenue for income-tax cuts results in a distribution that favors the wealthy. Policy Matters found that Gov. Kasich's 2012 proposal to increase the severance tax and use the revenues for an income-tax cut resulted in a $42 average tax cut for Ohio households in the middle quintile of earners and a $2,300 tax cut for the wealthiest households in years that the income tax giveback fund is $500 million. While HB 375 would require its own analysis – the numbers would be smaller – the basic pattern would be the same.

Severance taxes are needed to ensure proper oversight and regulation of the fracking industry, to mitigate impacts, to meet current needs of the state, and to build diversity in the economy for after the boom is over. An adequate, responsible severance tax can help do all those things. We must not lose the opportunity to harness the boom and invest in the future for all Ohioans.